No. 88-1316

(3)

Supreme Court, U.S.
FILED
MAR 8 1989
JOSEPH F. SPANIOL, JR.
CLERK

IN THE

SUPREME COURT OF THE UNITED STATES

October Term, 1988

COMPRESSED GAS CORPORATION - - Petitioner,

versus

UNITED STATES STEEL CORPORATION and
JACK B. KELLEY, INC. - - - - - Respondents.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Sixth Circuit

BRIEF IN OPPOSITION

JOHN R. McCALL
BROWN, TODD & HEYBURN
1600 Citizens Plaza
Louisville, Kentucky 40202
(502) 589-5400
Counsel of Record

AND

ROBERT Y. GWIN
BROWN, TODD & HEYBURN
1600 Citizens Plaza
Louisville, Kentucky 40202
(502) 589-5400

AND

WAYNE L. EMERY
USX CORPORATION
Law Department
600 Grant Street
Pittsburgh, Pennsylvania 15230
(412) 433-2898
Counsel for Respondents

WESTERFIELD-BONTE CO., 619 W. KENTUCKY—P.O. BOX 3231, LOUISVILLE, KY.

42 pp
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QUESTIONS PRESENTED[1]

I. Is the Seventh Amendment violated by the Sixth Circuit's ruling that there was insufficient evidence of fraudulent misrepresentation under Kentucky law to submit the issue to a jury?

II. Does the Sixth Circuit's application of Kentucky law create a conflict among federal circuits that apply the laws of different states in diversity cases?

III. Did the Sixth Circuit correctly apply Kentucky law limiting the recovery of alleged lost profits?

IV. May Congress pass a law fixing the rate of post-judgment interest in diversity cases?

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[1]Pursuant to United States Supreme Court Rule 28.1, USS provides the following information. United States Steel Corporation changed its name to USX Corporation in the summer of 1986. By stipulation of the parties, the trial was conducted using the name, United States Steel Corporation. USX Corporation is a publicly-owned corporation.

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No. 88-1316

IN THE

SUPREME COURT OF THE UNITED STATES

COMPRESSED GAS CORPORATION - - *Petitioner,*

v.

UNITED STATES STEEL CORPORATION and
JACK B. KELLEY, INC. - - - - *Respondents.*

ON PETITION FOR WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

BRIEF IN OPPOSITION

OPINIONS BELOW

In addition to the opinions and judgments reprinted in the appendix to the Petition for a Writ of Certiorari, the Judgment of the United States District Court for the Western District of Kentucky is reprinted in the Appendix at p. 1a.

STATEMENT OF THE CASE

The Opinion of the United States Court of Appeals for the Sixth Circuit correctly states the facts of this case. For brevity, United States Steel Corporation ("USS") and Jack B. Kelley, Inc. ("Kelley")[2] adopt

[2]Compressed Gas Corporation's Petition incorrectly refers to Jack B. Kelley, Inc. as Jack B. Kelley Co., Inc.

and incorporate by reference the facts set forth in that decision. (Appendix, pp. 5a-8a) USS and Kelley provide the following additional facts relevant to the issues before the Court.

(1) The evidence at trial established that 3T cylinders are safe containers for uncontaminated natural gas and no witness testified otherwise.

(2) Neither USS nor Kelley ever represented to anyone that 3T cylinders could be used to transport gases contaminated with hydrogen sulfide and water. In fact, USS advised all who inquired of the requirement for uncontaminated gas.

(3) The Department of Transportation ("DOT") by special permit issued in *1974* authorized transportation of "natural gas, proper shipping name methane" in 3T cylinders. In a *1973* preface comment which appeared in only one issue of the *Federal Register,* the DOT appeared to distinguish natural gas from methane and to interpret the regulations listing the gases approved for transport in 3T cylinders as excluding natural gas; however, it reversed its position when it later granted the 1974 permit specifically allowing natural gas transport in 3T cylinders and treating it as synonymous with methane.

USS had no actual knowledge of the 1973 preface comment (which never became a part of the regulations and never appeared in the *Code of Federal Regulations*). However, USS did have actual knowledge of the special permit allowing natural gas transport in 3T cylinders and equating natural gas with methane,

a gas specifically listed in the regulations as approved for transport in 3T cylinders. After the accident in this case, the DOT amended its regulations to exclude natural gas as a product suitable for transport in 3T cylinders, but the DOT specifically acknowledged that its prior regulations had confused the industry.

(4) The DOT regulates both manufacturers and *users* of 3T cylinders. The *user* regulations published in the *Code of Federal Regulations* and directly applicable to Compressed Gas Corporation ("CGC") prohibited users of 3T cylinders from introducing into the cylinders any substance that might impair the cylinders' serviceability. Every expert at trial agreed that hydrogen sulfide would impair the cylinders' serviceability. Post accident analysis of CGC's natural gas wells revealed that, contrary to CGC's pre-accident representations to Kelley and others, the wells contained high concentrations of hydrogen sulfide and water. Every expert at trial agreed that, absent CGC's introduction of hydrogen sulfide or water into the cylinders, the rupture would not have occurred.

(5) CGC ignored or refused to learn the DOT regulations applicable to its activities. CGC's founder and principal, Gobel Mattingly, saw a Kelley brochure which promoted 3T cylinders, but he never read the DOT regulations that were identified on the front of the brochure. Prior to the accident, at CGC's request, Kelley sent CGC a copy of the actual DOT regulations specifically setting forth the gases approved for transport in 3T cylinders. Again, Mattingly testified he

did not read the regulations or the cover letter that came with them. In addition, while visiting Kelley's Texas offices, Mattingly saw but *did not read* a USS brochure which advised that the DOT governed the use of the cylinders. Mattingly testified that he did not read any USS brochures, rather he only "looked at the pictures."

(6) No natural gas trailer transport business ultimately made a net profit. The only other similar operation in CGC's geographic region discontinued operations because of economic infeasibility. During the gas curtailments in the late 1970's a nearby southern Indiana hotel set up an operation similar to CGC's to meet its gas needs. After only two months of operation, it discontinued the project because it could buy gas more cheaply from the local utility than it could run the truck transport operation.

(7) In an attempt to create support for its claim for lost profits, CGC has mischaracterized the evidence from Don Fowler of Texas Gas Transport. Contrary to statements in CGC's Petition, Fowler never testified that his company made $14 million in gross revenues. CGC also fails to note that Fowler's companies' *gross* revenues resulted from a variety of enterprises unrelated to its gas transport business. Fowler specifically testified that he did not realize a net *profit* on his gas transport business. Moreover, in no event could Fowler's operation provide support for CGC's claim for lost profits. Fowler operated in a different market area 900 miles from CGC's operations, and Fowler

used only uncontaminated natural gas. Fowler pointed out that he had considered and abandoned efforts to operate in Kentucky because he could not find wells with gas in the quantity and quality necessary to justify a gas hauling business.

REASONS FOR DENIAL OF WRIT

I. Summary Of Arguments

This case is a diversity, tort case in which Kentucky substantive law provides the rule of decision. CGC has overlooked this simple fact and has presented nothing warranting a writ of certiorari in its Petition.

The Sixth Circuit received on appeal a trial court verdict awarding damages almost forty times the trial evidence of property damage. The Sixth Circuit could not find sufficient evidence in the record to justify a jury finding of fraudulent misrepresentation, reliance on misrepresentation, or lost profits. Reviewing the record and applying the standards of review required of it, the Sixth Circuit reversed the trial court and narrowed the issues for retrial.

Each of the four arguments CGC presents in its Petition fails: (1) the Seventh Amendment does not inhibit a directed verdict or JNOV where insufficient evidence exists to submit the case to the jury. *Galloway* v. *United States,* 319 U.S. 372 (1943). (2) Decisions of federal courts of appeals applying the laws of different states in diversity actions do not create reviewable conflicts among the circuits. *Ruhlin* v. *New*

York Life Ins. Co., 304 U.S. 202, 206 (1938). (3) Under applicable Kentucky law and, indeed, federal law as well, CGC failed to produce sufficient evidence that it could ever make a profit even absent the accident. *Pauline's Chicken Villa, Inc.* v. *KFC Corp.*, Ky., 701 S.W. 2d 399, 401 (1985); *Story Parchment Co.* v. *Paterson Parchment Paper Co.*, 282 U.S. 555, 562 (1931). (4) Finally, 28 U.S.C. § 1961(a) controls the rate of post-judgment interest on diversity cases. "The accrual of interest on judgments is an ordinary incident of judicial relief, and . . . the power that creates the tribunal that enters the judgment can also provide for such ordinary incidents." *Weitz Co., Inc.* v. *Mo-Kan Carpet, Inc.*, 723 F. 2d 1382, 1386 8th Cir. 1983). Therefore, CGC has presented no issue for review by this Court and its Petition must be denied.

II. Is The Seventh Amendment Violated By The Sixth Circuit's Ruling That There Was Insufficient Evidence Of Fraud To Submit The Issue To A Jury?

A. The Court May Withdraw a Case From the Jury For Insufficient Evidence.

The court's decision in *Galloway* v. *United States*, 319 U.S. 372 (1943) confirms the federal court's power to withdraw a case from a jury based on insufficiency of the evidence. In *Galloway*, the court stated:

> If the intention is to claim generally that the [Seventh] Amendment deprives the federal courts of power to direct a verdict for insufficiency of evidence, the short answer is the contention has been

> foreclosed by repeated decisions made here consistently for nearly a century.
>
> * * *
>
> It is not that 'the rules of the common law' in 1791 deprived trial courts of power to withdraw cases from the jury, because not made out, or appellate courts of power to review such determinations. The jury was not absolute master of the facts in 1791.

319 U.S. at 389-90.

B. The Sixth Circuit Correctly Determined Insufficient Evidence of Fraud.

The Sixth Circuit correctly ruled that CGC failed to produce sufficient evidence of fraud to permit submission of the issue to the jury.

Contrary to the representation in CGC's Petition, the Sixth Circuit specifically stated the standard of review it applied. At page 6a of its Opinion, the Court states that it "will reverse the denial of a judgment notwithstanding the verdict if we do not find the evidence of fraud of probative value having fitness to induce conviction in the minds of reasonable persons". The Court goes on to find at page 7a of its Opinion that CGC failed to present " 'more than a scintilla of evidence' toward meeting" its burden of proof. Both the Kentucky courts and the federal courts follow the same "more than a scintilla of evidence" standard regarding sufficiency of the evidence as the Sixth Circuit applied in this case. *Wadkins' Adm'x* v. *Chesapeake & Ohio Railway Co.*, Ky., 298 S.W. 2d 7, 9 (1956); *Gun-*

ning v. *Cooley,* 281 U.S. 90, 94 (1930); *Improvement Co.* v. *Munson,* 81 U.S. (14 Wall.) 442, 449 (1871).

Kentucky law requires proof of all elements of fraud by clear and convincing evidence. *Wahba* v. *Don Corlett Motors, Inc.,* Ky. App., 573 S.W. 2d 357, 359 (1978). To overcome a directed verdict on a fraud claim under Kentucky law, the party asserting the fraud must sustain the burden of proof. This burden requires clear and convincing evidence of all elements of fraud. In other words, as stated by this Court in a case involving the clear and convincing evidence burden of proof in the context of the malice element in a libel action:

> Progressing to the specific issue in this case, we are convinced that the inquiry involved in a ruling on a motion for summary judgment or *for a directed verdict* necessarily implicates the susbtantive burden of proof that would apply at the trial on the merits.
>
> * * *
>
> [T]hat is, whether the evidence presented is such that a reasonable jury might find that actual malice had been shown with convincing clarity (emphasis added).

Anderson v. *Liberty Lobby, Inc.,* 477 U.S. 242, 252, 257 (1986).

Similarly, the standard of review in the present case is whether there was more than a scintilla of evidence of probative value having fitness to induce conviction in the minds of reasonable persons that *all* the *elements*

of fraud had been shown *with convincing clarity.* The Sixth Circuit properly ruled that CGC did not produce evidence sufficient to warrant submission of its fraud claim to the jury. The Appellate Court acted within its well-established power and no Seventh Amendment issue arises from its ruling.

C. The Sixth Circuit Properly Considered All Evidence of Reliance.

CGC's allegation that the Sixth Circuit's Opinion "rests in part upon the wrong evidence" has no basis. CGC complains that the Court did not properly consider page 16 of the USS brochure when it ruled that CGC presented insufficient evidence of reliance to support a fraud claim. CGC specifically raised the same argument before the Court of Appeals in its Petition for Rehearing. The Court of Appeals confirmed that it did consider precisely the same evidentiary issue when it stated in its order denying the Petition:

> The panel has further reviewed the petition for rehearing and concludes that the issues raised in the petition were fully considered upon the original submission and decision of the case. (Appendix, p. 18a)

Further, the Sixth Circuit correctly construed this exhibit in its analysis and opinion. The Sixth Circuit noted in its Opinion at page 11a, the USS brochure relates to "various uses to which seamless pressure vessels . . . can be put." The brochure refers to gases that a variety of USS pressure vessels can trans-

port without specifying which gases are suitable for which vessels. The USS brochure contains *no* representation regarding the particular use (contaminated natural gas) to which CGC put 3T cylinders. The Sixth Circuit correctly noted that CGC could not rely on the brochure without further inquiry.

Moreover, the record establishes that CGC could not have relied on the USS brochure at trial because Mattingly never read the brochure. Although Mattingly read to the jury at trial portions of page 16 of the USS brochure, when confronted with the bold red letters on page 16 relating to DOT regulations (Mattingly claimed he did not know prior to the accident that the DOT regulated the use of 3T cylinders), Mattingly stated: "No, I did not rely, no, there was any rules for the shipper. I didn't read all that brochure; still haven't." Mattingly went on to explain "I looked at all the pictures, I will say that." Finally, when pressed for an answer as to whether he did or did not read page 16 of the USS brochure, Mattingly confessed that he did not know.

The Sixth Circuit considered the entire USS brochure. It properly concluded that the testimony related to the brochure does not constitute sufficient evidence of reliance to justify submission of CGC's fraud claim to the jury.

III. The Sixth Circuit's Application Of Kentucky Law Creates No Conflict Among Federal Circuits That Apply The Laws Of Other States In Diversity Cases.

Contrary to CGC's argument, no reviewable conflict exists among the federal circuits as to what constitutes reliance as an element of a fraud claim in a diversity case. State law defines the substantive elements of the cause of action. 28 U.S.C. § 1652; *Erie R. Co.* v. *Tompkins,* 304 U.S. 64 (1938); *Fashion Originators Guild* v. *Federal T. Com.,* 312 U.S. 457 (1941). The Sixth Circuit correctly applied and specifically cited the Kentucky authority establishing the substantive law on which it decided this diversity case. (Appendix, pp. 8a, 10a-11a, 13a)

CGC does not argue that the Sixth Circuit incorrectly applied Kentucky law. Rather, CGC cites cases from other federal circuits applying the law of other states and argues that they demonstrate a reviewable conflict among the circuits. It is axiomatic and this Court has held that decisions by federal courts of appeals applying different laws of different states do not create reviewable conflicts among the circuits. *Ruhlin* v. *New York Life Ins. Co.,* 304 U.S. 202, 206 (1938). The Sixth Circuit's application of Kentucky law creates no conflict with the decisions of other federal appellate courts applying the laws of other states. CGC has presented no issue warranting a writ of certiorari.

IV. The Sixth Circuit Correctly Applied Kentucky Law Regarding Recovery Of Alleged Lost Profits.

A. Kentucky Law Requires Proof of Some Profitability.

The Sixth Circuit applying Kentucky law correctly held that CGC did not produce sufficient evidence of the fact that, absent the accident, CGC could have made a profit. As the Sixth Circuit pointed out at page 13 of its Opinion (Appendix, p. 15a) "Kentucky law requires that CGC establish the fact of lost profits with reasonable certainty. *Pauline's Chicken Villa, Inc.* v. *KFC Corp.*, 701 S.W. 2d 399, 401 (Ky. 1985)."

The court in *Pauline's* referred to nine factors existing in that case which eliminated the "uncertainty" of new business profitability. The Sixth Circuit listed the nine *Pauline's* factors and observed that Kentucky's highest court had removed "virtually all the uncertain variables" for determining the profitability test for a new business under Kentucky law. Contrary to CGC's allegations, the Sixth Circuit did not require that CGC prove all of the nine factors listed in *Pauline's*. Rather, the Sixth Circuit expressly stated that "[*n*]*ot one* of these factors existed in this case" (emphasis added). (Appendix, p. 15a).

CGC misunderstands Kentucky law when it argues that it can recover lost profits merely by offering evidence that USS and Kelley caused *some kind* of damage. That there was damage of some kind does not mean there was damage of a particular kind. One

of several possible kinds of damage is "lost profits". While it is true that the *amount* of lost profits need not be proven with certainty, the *fact* of lost profits still must be proven in accordance with Kentucky law. Kentucky law requires that CGC prove with *reasonable certainty* that USS and Kelley caused CGC to suffer *lost profits*. Consequently, CGC must prove with reasonable certainty that, absent the accident, it would have made profits.

B. Trial Evidence Established No Profitability.

In this case, the Sixth Circuit correctly held that CGC failed to introduce sufficient probative evidence that it would have made any profits. The evidence at trial established that:

(a) CGC never in its entire existence made a profit;

(b) CGC had a pre-accident operating history of less than ten days without any profit;

(c) no natural gas cylinder trailer transport operation anywhere ultimately returned a profit; and

(d) the only similar operation in the same geographic region discontinued operations because of economic infeasibility.

Moreover, CGC's only lost profits evidence came from its economist, Dr. Donald Monath, who merely subtracted CGC's pre-operational expense estimates from the projected maximum estimated revenues CGC could realize if it operated 24 hours a day, 365 days

a year for ten years. Dr. Monath made no investigation and offered no testimony regarding CGC's ability to meet its expense or income projections or realize any profits at all.

CGC's failure of proof is highlighted by the equivocation of Dr. Monath. He made no effort to determine whether CGC, absent the accident, could even have continued to operate. Dr. Monath had no information about how CGC created the pre-operational cost estimates or expectations on which he relied. Dr. Monath did not know the company had only a ten-day operating history or that CGC's management had no experience in the gas transport industry. Dr. Monath had no knowledge of the contaminated quality and inadequate quantity of CGC's product. He did not consider the negative financial history of other natural gas transporters.

Applying Kentucky law, the Sixth Circuit correctly found this evidence insufficient to submit the speculative issue of lost profits to the jury.

C. CGC's Citation to Unrelated Federal Statutes Does Not Alter the Kentucky Profitability Standard.

CGC's argument is not supported by its cited authorities. The federal question cases CGC cites involve claims under various federal statutes. They do not control this diversity case which is a common law tort case in which Kentucky's substantive law provides the rule of decision. Moreover, the standard applied in the cases CGC cites does not significantly differ from the Kentucky standard. Thus, the failure

of proof in this case supports the Sixth Circuit's holding under either standard. For example, the passage from *Story Parchment Co.* v. *Paterson Parchment Paper Co.*, 282 U.S. 555 (1931) quoted at page 21 of CGC's Petition states in part:

> "The rule which precludes the recovery of uncertain damages applies to such as are not the certain result of the wrong, not to those damages which are definitely attributable to the wrong and only uncertain in respect of amount."

282 U.S. at 562.

The party seeking lost profits must prove that "those damages," *i.e.*, the lost profits, resulted from the wrong. In this case, CGC did not sufficiently establish that it could have made any profit regardless of the accident. Therefore, irrespective of the law applied, the Sixth Circuit correctly decided that CGC failed to present sufficient evidence of lost profits to permit an instruction on the issue.

V. Congress Has The Authority To Pass A Law Fixing The Rate Of Post-Judgment Interest In Diversity Cases.

28 U.S.C. § 1961(a) sets the rate of interest on any money judgments in civil cases in U.S. District Courts. No exemption exists for diversity cases. Therefore, the statute governs the post-judgment interest rate in this case unless the provision is unconstitutional. *Hanna* v. *Plumer*, 380 U.S. 460, 471 (1965); U.S. Const. Art.

VI, Cl. 2.[3] In finding the statute constitutional, the Court in *Weitz Co., Inc.* v. *Mo-Kan Carpet, Inc.*, 723 F. 2d 1382, 1386 (8th Cir. 1983) stated:

> Congress has the power, under Article III of the Constitution, to ordain and establish inferior federal courts, including this Court and the District Court which entered the judgment below. It has the power to pass all laws necessary and proper for the execution of powers specifically granted. The accrual of interest is an ordinary incident of judicial relief, and we think it clear that the power that creates the tribunal that enters the judgment can also provide for such ordinary incidents.
>
> The *Erie* doctrine does not require a different result. Even if the rate of interest that a judgment will bear is in some sense "substantive" in that it is a part of the damages recovered by the winning side, it is also easily susceptible of characterization as "procedural," since it has to do exclusively with events that occur after a dispute gets to court. The question of interest, therefore, is at most in "the uncertain area between substance and procedure," and rationally capable of classification as either. *Hanna* v. *Plumer, supra,* 380 U.S. at 472, 85 S. Ct. at 1144. It is therefore a subject with respect to which Congress has full power to legislate, even as to cases that get into the federal courts only because of diversity of citizenship.

See also, Nissho-Iwai Co. v. *Occidental Crude Sales, Inc.*, 848 F. 2d 613, 622-624 (5th Cir. 1988); *Everaard*

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[3]Because CGC has not complied with Rule 28(3)(b) of the U.S. Supreme Court Rules, it is assumed that CGC does not challenge the constitutionality of 28 U.S.C. § 1961(a).

v. *Hartfort Acc. and Indem. Co.*, 842 F. 2d 1186, 1193, 1194 (10th Cir. 1988); *G. M. Brod & Co.* v. *U.S. Home Corp.*, 759 F. 2d 1526, 1542 (11th Cir. 1985); *Bailey* v. *Chattem, Inc.*, 838 F. 2d 149, 152, 153 (6th Cir.), *cert. denied*, — U.S. —, 108 S. Ct. 2831 (1988); *Northrop Corp.* v. *Triad Intern. Marketing, S.A.*, 842 F. 2d 1154, 1155-1156 (9th Cir. 1988). These authorities specifically reject CGC's argument that 28 U.S.C. § 1961(a) violates the *Erie* doctrine and establish that CGC's argument has no merit.

CONCLUSION

CGC has presented no argument warranting a writ of certiorari. The Sixth Circuit's proper application of Kentucky law to this diversity case creates no unresolved constitutional questions nor any reviewable conflict among federal circuits. USS and Kelley respectfully request that this Court deny CGC's Petition for a Writ of Certiorari.

Respectfully submitted,

JOHN R. MCCALL
BROWN, TODD & HEYBURN
1600 Citizens Plaza
Louisville, Kentucky 40202
(502) 589-5400

Counsel of Record

AND

ROBERT Y. GWIN
BROWN, TODD & HEYBURN
1600 Citizens Plaza
Louisville, Kentucky 40202
(502) 589-5400

AND

WAYNE L. EMERY
USX CORPORATION
Law Department
600 Grant Street
Pittsburgh, Pennsylvania 15230
(412) 433-2898

Counsel for Respondents

APPENDIX

CIV 31
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JUDGMENT IN A CIVIL CASE

United States District Court	DISTRICT: WESTERN DISTRICT OF KENTUCKY
CASE TITLE: COMPRESSED GAS CORPORATION, INC. V. UNITED STATES STEEL CORPORATION JACK B. KELLEY CO., INC.	DOCKET NUMBER: 78-0063-0 (M) 78-0144-0 (M)
	NAME OF JUDGE OR MAGISTRATE: HON. RONALD E. MEREDITH

☒ **Jury Verdict.** This action came before the Court and a jury with the judicial officer named above presiding. The issues have been tried and the jury has rendered its verdict.

☐ **Decision by Court.** This action came to trial or hearing before the Court with the judge (magistrate) named above presiding. The issues have been tried or heard and a decision has been rendered.

IT IS ORDERED AND ADJUDGED

Compressed Gas Corporation is found not to be at fault.

Jack B. Kelley Co., Inc. and United States Steel Corporation are found to be at fault in the following proportions:

Jack B. Kelley Co., Inc.	30%
United States Steel Corporation	70%

Compressed Gas Corporation is awarded damages as follows:

Compressed Gas Corporation, Inc.-Indebtedness	$533,809.66
Post Accident Expenses Incurred-Balance	$45,307.54
Lost Profits	$1,137,154.00
Initial Investment	$50,000.00
TOTAL DAMAGES	$1,766,271.20

IT IS FURTHER ORDERED, based on the above findings, that judgment shall be entered in the amount of ONE MILLION TWO HUNDRED THIRTY SIX THOUSAND THREE HUNDRED EIGHTY NINE DOLLARS and EIGHTY FOUR CENTS($1,236,389.84) against the defendant, United States Steel Corporation and shall be entered in the amount of FIVE HUNDRED TWENTY NINE THOUSAND EIGHT HUNDRED EIGHTY ONE DOLLARS and THIRTY SIX CENTS($529,881.36) against the defendant, Jack B. Kelley Co., Inc. The plaintiff, Compressed Gas Corporation, Inc., shall recover a total sum of $1,766,271.20 as set forth above, with interest thereon at the rate of twelve (12) percent compounded annually from the date of entry of this judgment until paid, plus costs herein expended.

This is a final and appealable judgment, there being no just cause for delay.

ENTERED
DEC 17 1986
DATE
JESSE W. GRIDER, CLERK
BY DEPUTY CLERK

CLERK		
JESSE W. GRIDER		
(BY) DEPUTY CLERK		
NADINE C. SMITH	Nadine C. Smith	12-11-86

APPENDIX 2

Nos. 87-5535/87-5608

RECOMMENDED FOR FULL TEXT PUBLICATION
See, Sixth Circuit Rule 24

UNITED STATES COURT OF APPEALS

FOR THE SIXTH CIRCUIT

COMPRESSED GAS CORPORATION, INC., - *Plaintiff-Appellee Cross-Appellant,*

v.

UNITED STATES STEEL CORPORATION and JACK B. KELLEY, INC., - - - *Defendants-Appellants Cross-Appellees.*

On Appeal From the United States District Court for the Western District of Kentucky
Decided and Filed September 21, 1988

Before: KEITH, KENNEDY and NELSON, Circuit Judges.

I.

KEITH, Circuit Judge. Defendants United States Steel Corporation ("USS") and Jack Kelley appeal, and plaintiff Compressed Gas Corporation ("CGC") cross-appeals, the jury verdict for plaintiff in this diversity action resulting from the explosion of a steel cylinder. The "3T" cylinder, manufactured by defendant USS and leased by defendant Jack B. Kelley, Inc., ("Kelley") ruptured while being filled with natural gas apparently containing certain contaminants. The explosion killed two persons, injured four others, and caused property damage. The personal injury

and wrongful death claims were adjudicated in a separate lawsuit. At trial in this action, CGC claimed that it had been defrauded by the misrepresentations of USS and Kelley that the cylinders were safe for transporting natural gas and approved for that purpose by the United States Department of Transportation ("DOT"). CGC also made a products liability claim for a defective cylinder and failure to warn. This appeal focuses on the property damage resulting to plaintiff CGC from the rupture of the cylinder.

For the reasons set forth below, we believe the jury was improperly permitted to find against USS and Kelley on a theory of fraudulent misrepresentation, and was also improperly permitted to include CGC's alleged "lost profits" in the damages award. Because the jury reached a damages verdict that apparently was calculated upon a theory of fraudulent misrepresentation, and which also incorporated CGC's alleged lost profits, the verdict against the defendants must be vacated. We must therefore reverse on those issues and remand the entire case to the district court for a new trial. Further, we believe that an incorrect rate of interest was applied to the judgment below. We affirm on all of the remaining issues.

This case was tried as a summary jury trial on February 13, 1985, which resulted in a verdict of $200,000 against defendants USS and Kelley. The case was then reassigned to the Honorable Ronald Meredith of the Western District of Kentucky, who allowed additional discovery. A full trial on the merits took place on October 21, 1986. On December 11, 1986, the jury returned a verdict, apportioning fault at 70% against USS and 30% against Kelley, and awarding $1,766,271.20 in damages to CGC. The district court set the post-judgment interest rate at 12% to be compounded annually. The district court denied USS's and Kelley's motions for judgment notwithstanding the verdict and new trial.

Defendants USS and Kelley present a host of issues on appeal. They urge: 1) that the absence of proof of fraudulent misrepresentation entitled them to a directed verdict on the question of whether they fraudulently induced CGC to lease their steel cylinders; 2) that the jury instructions impermissibly allowed a solitary instruction on damages for two separate theories of liability; 3) that there was insufficient evidence to support a jury instruction on lost profits; 4) that Kentucky law requires the application of contributory rather than comparative negligence to products liability cases; 5) that the trial court abused its discretion in allowing CGC to conduct additional discovery following the summary jury trial; 6) that the trial court erred in applying the 12% post-judgment interest rate; and 7) that CGC's agreement to indemnify Kelley from all liability arising from the use of leased cylinder trailers entitled Kelley to a directed verdict on claims against him. On cross-appeal, CGC argues that punitive damages should have been submitted to the jury.

II. FACTS

Gobel Mattingly, the retired owner of a highway construction company, incorporated CGC for the purpose of hauling natural gas from wells to commercial pipelines. A five-paragraph trade journal article describing the successful gas transportation operation of Texas Gas Transport ("Texas Gas") inspired Mattingly to enter the gas transportation business in August, 1976. When he incorporated CGC, Mattingly had no training or experience in gas transportation or compression. Joint Appendix at 927.

Mattingly visited Jack Kelley's Texas facilities to lease the special trailers that hauled the USS steel cylinders used in transporting natural gas. Kelley was one of four or five principal purchasers of USS seamless steel cylinders. He would purchase the cylinders from USS and fabricate

trailers for them. Each trailer could transport twelve cylinders. As well as using the trailers to transport a variety of compressed gases, Kelley sold or leased the cylinder trailers to others. Mattingly executed a trailer lease with Kelley in February, 1977.

On October 27, 1977, CGC's compressor station was damaged when a 3T seamless steel cylinder manufactured by USS ruptured while being filled with natural gas apparently tainted by the contaminants hydrogen sulfide and water. CGC repaired its property damage for $45,307.54.

The experts who testified at trial generally agreed that the explosion of the steel cylinder would not have occurred if hydrogen sulfide and water had not combined with natural gas in the cylinder. Natural gas is odorless and flammable, and is composed principally of methane. Sometimes natural gas, when extracted from the ground, contains contaminants such as hydrogen sulfide. Gas that does not contain significant hydrogen sulfide contamination is labeled "sweet" gas, while contaminated gas is called "sour" gas. In the gas industry, contaminated gas is considered dangerous because hydrogen sulfide in the presence of water will embrittle high-strength steel, causing it to fail under stress within hours. This is known in the industry as "sulfide stress cracking," and is recognized and understood. For sulfide stress cracking to occur, three factors must be present: hydrogen sulfide, water and susceptible metal. At the time of the accident CGC had neither installed a dehydrator nor any sulfide removal equipment at its gas wells, unlike most other gas well operations in the United States.

When Mattingly and Kelley met to arrange the lease of the 3T cylinders and trailers, Kelley testified that he told Mattingly that Mattingly's "gas can't have any moisture in it or no hydrogen sulfide." Joint Appendix at 800. Kelley testified that he repeated this warning to Mattingly during Mattingly's second visit to his offices. Mattingly testified

that "someone" had advised him that the gas had to be dry to be hauled safely in the 3T tubes, but he was not sure that that person was Kelley. *Id.* at 919. Mattingly saw a Kelley brochure which promoted the cylinder trailers, but never read the DOT regulations that were on the front of the brochure. In September, 1977, at CGC's request, Kelley sent Mattingly a copy of the DOT regulations setting forth the gases suitable for transport in 3T cylinders. Mattingly testified that again he did not read the regulations sent to him. *Id.* at 924.

Mattingly said that he showed Kelley an analysis of a gas well that indicated the gas was sweet. He did not, however, have the wells tested for hydrogen sulfide or moisture. *Id.* at 731. The test that he had showed Kelley was over a year old, and contained no moisture reading. Tests conducted on the wells following the accident revealed high concentrations of hydrogen sulfide and moisture. *Id.* at 615-16, 1043-45.

Aside from his three visits with Kelley, Mattingly's contacts with USS itself were scant. In September, 1976, while visiting the Kelley offices, Mattingly saw but did not read a USS brochure, and instead only "looked at the pictures." *Id.* at 924. In June of 1977, Mattingly saw an advertisement in the *Wall Street Journal* promoting USS cylinders for use in natural gas transportation. The advertisement gave no specific cylinder identification or detailed technical information, but gave a telephone number and invited inquiries from persons interested in further information. CGC never called the number in response to the advertisement.

Prior to the accident, neither USS nor Kelley ever had any complaints that, or knowledge that, any high pressure jumbo cylinder had ruptured in service. *Id.* at 983. As of the date of the accident, USS had produced over 15,000 jumbo steel cylinders. The 3T cylinder had transported

approximately 48,000 loads of natural gas without difficulty. According to testimony at trial, never in USS's history had one of its cylinders ruptured in any kind of service until the explosion at issue here. *Id.*

III. ANALYSIS

A. *The Fraud Claims*

CGC claims that USS and Kelley fraudulently induced CGC to use the 3T cylinders by "misrepresenting" the cylinders as safe containers for natural gas transportation, and by misrepresenting that the DOT regulations authorized natural gas transportation in 3T cylinders.

Under Kentucky law, which governs this diversity action, the plaintiff must establish six elements to sustain a fraud claim. There must be: 1) a material misrepresentation, 2) which is false, 3) which was known to be false, or made recklessly, 4) made with inducement to be acted upon, 5) which is acted upon in reliance thereon, and 6) causes injury. *Wahba* v. *Don Corlett Motors, Inc.*, 573 S.W. 2d 357, 359 (Ky. Ct. App. 1978). Kentucky law also recognizes a presumption of innocence and honesty against fraud claims. *Terrill* v. *Carpenter*, 143 F. Supp. 747, 753-54 (E.D. Ky. 1956), *aff'd*, 249 F. 2d 142 (6th Cir. 1957); *T.M. Crutcher Laboratory* v. *Crutcher*, 288 Ky. 709, 720, 157 S.W. 2d 314, 319 (1941). The plaintiff bears the burden of proving fraud by clear and convincing evidence. *Brooks* v. *United Kentucky Bank*, 659 S.W. 2d 213, 216 (Ky. Ct. App. 1983); *Wahba*, 573 S.W. 2d at 359; *Sanford Construction Co.* v. *S. & H. Contractors, Inc.*, 443 S.W. 2d 227 (Ky. 1969). Under Kentucky law, a motion for a judgment notwithstanding the verdict is subject to a "more than a scintilla" of evidence rule; that is, we will reverse the denial of a judgment notwithstanding the verdict if we do not find evidence of fraud of probative value having fitness to induce conviction in the minds of reasonable persons. *Wadkins'*

Adm'x v. *Chesapeake & Ohio Railway Co.*, 298 S.W. 2d 7, 9 (Ky. 1956). We find that plaintiff has not presented "more than a scintilla of evidence" toward meeting his burden of proof.

1. *No Material Misrepresentation Known to be False or Made Recklessly.* CGC argues that USS and Kelley falsely represented that the steel tubes were safe for "natural gas." Indeed, the main dispute between the parties appears to center around their conflicting definitions of the term "natural gas." CGC apparently defines "natural gas" as that which is extracted from wells in its natural state, without dehydration or without removal of hydrogen sulfide. In other words, CGC's definition is that of untreated natural gas, which may contain certain amounts of the contaminants at issue in this action.

USS and Kelley, on the other hand, defined "natural gas" as that which is suitable for transport in their steel tubes—i.e., non-corrosive, dry and sweet gas, absent contaminants. This dry gas, they claim, is "essentially methane." Indeed, prior to the accident in this case, defendants claim, the DOT and the industry had apparently used the terms "natural gas" and "methane" interchangably. The evidence shows that USS and Kelley were reasonable in their belief that "natural gas" and "methane" could be considered at the time to be virtual equivalents.

Kelley's operation produced a brochure which specified that 3T cylinders were "approved for several gases including Methane." Joint Appendix at 467. Kelley sent a copy of the DOT regulations to Mattingly—regulations which specified that the tubes were authorized to carry methane; in the cover letter to those regulations, William C. George of Kelley's firm wrote that "Part 173.302, Sub 3, of the Code authorizes the transportation of methane (natural gas) in 3-T tubes." Joint Appendix at 496-97. Kelley painted "METHANE" on the side of the cylinder trailers in

bold letters. In other words, Kelley's firm apparently used the terms interchangeably.

A less plausible interpretation of the same facts, and one that CGC would have us believe, is that Kelley somehow connived to make CGC think that methane and natural gas were one and the same, when he believed that this was not true. That version of events would have Kelley painting his trucks with the word "METHANE" even though he knew that they were to be used for transporting the less pure natural gas, and duping CGC into thinking that the DOT regulations were meant to cover natural gas as well as methane. The jury found CGC's story convincing, and we do not overturn their finding lightly. However, under Kentucky law, as we have stated above, there is a presumption of honesty against fraud claims. " 'In actions involving fraud . . . where the facts present a double aspect, one consistent with fair dealing and the other involving dishonesty of purpose, the court, unless the scale decidedly predominates for the latter, will strike the balance in favor of honesty and innocence.' " *T.M. Crutcher Laboratory,* 157 S.W. 2d at 319 (quoting *Pacific Mut. L. Ins. Co.* v. *Arnold,* 262 Ky. 267, 276, 90 S.W. 2d 44, 49 (1935)). There was no evidence proferred of duplicitous behavior or intent to deceive on the part of Kelley or Kelley's operation. We find that Kelley's meshing of "natural gas" and "methane" was more consistent with his honest belief that the terms were interchangeable than with any attempt to fraudulently conceal the truth.

The closest that plaintiff comes to proving fraud with respect to Kelley is the cover letter from Kelley's assistant traffic manager defining the two terms as one. A copy of the DOT regulations was sent to plaintiff with the letter. This representation, to the extent that it is a misrepresentation of law, is not actionable in Kentucky. *Fields* v. *Life & Casualty Co. of Tenn.,* 349 F. Supp. 612, 615 (E.D. Ky.

1972); *Mosley* v. *Owensboro Municipal Housing Comm'n.*, 252 S.W. 2d 880, 881 (Ky. 1952). Moreover, Mattingly did not even read the letter.

USS also used the terms "methane" and "natural gas" interchangeably, according to Peter G. Fairchock, Chief Metallurgist at the Christy Park Plant of USS. Joint Appendix at 1002. More importantly, however, the DOT used the terms interchangeably on a shipping permit, which recited:

2. COMMODITY. Natural Gas.
3. PROPER SHIPPING NAME (49 CFR 172.5) Methane.

The DOT also recognized that the industry was using the terms interchangeably, and, after the accident, promulgated a clarification which distinguished natural gas from methane, a primary component of natural gas. 43 Fed. Reg. 13,382 (1978) (to be codified at 49 C.F.R. § 173.302(a)).

While it is fairly clear in retrospect that it would be irresponsible in 1988 to use "natural gas" when what is really meant is pure methane, at the time of the accident, this was not the practice. Thus, we believe that in 1977, USS and Kelley properly represented the DOT's regulations as they reasonably interpreted them.[1]

As to the misrepresentations specifically made by USS, CGC claims basically that an advertisement in the *Wall*

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[1]The only indication that the DOT did not intend to permit 3T cylinders for natural gas transport came from a "preface" to a comment in a 1973 issue of the *Federal Register*, 38 Fed. Reg. 21,989 (1973). This preface appeared prior to the DOT's issuing the shipping permit mentioned above permitting 3T cylinders in natural gas service, and prior to the Texas Gas operation. In addition, the preface never became part of the regulations and was not published in the C.F.R. Prior to the accident, USS had no knowledge of the preface. Joint Appendix at 985.

Street Journal was sufficient to establish evidence of fraud. The advertisement generally promoted USS pressure cylinders for use in natural gas transportation. Joint Appendix at 535. The ad did not specifically identify any cylinders, and instead provided a telephone number to call for inquiries. CGC never contacted USS in response to the ad, and therefore received no representations about the cylinders. CGC also claims that USS misrepresented the use of the cylinders through a USS brochure that Mattingly saw in Kelley's offices. Yet, since he never read the brochure, Mattingly could not have gleaned any misrepresentations from it.

2. *No Reliance.* More striking, however, than the paucity of evidence showing any material misrepresentation is the absence of evidence of reliance. The proof offered at trial simply does not establish that Mattingly relied on statements made by USS or Kelley. Rather, Mattingly testified that he never read the brochures by USS or Kelley, nor did he telephone USS in response to the advertisement in the *Wall Street Journal.* Indeed, that article appeared after he had already committed himself to his new business venture. As defendants indicate in their brief, from September 1976 to April 1977, Mattingly incorporated CGC, obtained various quotes on compressor equipment, negotiated with potential buyers of his gas, entered into lease agreements for 3T cylinder trailers from Kelley, executed a contract giving him rights to various gas wells to be used in his operation, began making improvements to the road leading to the compressor site and began laying pipes to transport the gas from the wellheads to the compressor site. The *Wall Street Journal* article appeared months later.

Mattingly claims that he used the article to obtain a loan for his business. Although it is possible that the Small Business Administration may have relied on the advertise-

ment in granting Mattingly the loan (and there was no proof of this), that does not establish that *Mattingly* relied on the advertisement in using the 3T cylinders. In fact, the lease agreement for the cylinders was signed and completed a full four months before the advertisement appeared. Whether the Small Business Administration used the advertisement to grant a loan is irrelevant to the claim that USS fraudulently misrepresented the use of 3T cylinders to Mattingly. Kentucky law requires that the party claiming fraud show that he or she relied on the alleged misrepresentation, not a third party. *Wilson* v. *Henry*, 340 S.W. 2d 449, 451 (Ky. 1960).

Moreover, CGC never telephoned USS in response to the advertisement. It is difficult for us to imagine reliance on a fraudulent misrepresentation when the advertisement in question was non-specific, made no promises, and when CGC never even exhibited enough "reliance" on the ad to call the telephone number listed. CGC cannot now allege that *if* they *had* called the number, they *would have* relied on some hypothetical USS statement about the propensities of natural gas. Hypotheticals do not constitute reliance. Even so, every person who testified about having spoken with USS regarding the use of 3T cylinders for natural gas transportation acknowledged that USS specified that 3T cylinders were suitable only for sweet, dry gas.

An examination of the brochures that CGC claims also induced reliance supports our conclusion. These brochures are presentations of the various uses to which "seamless pressure vessels" (USS cylinders) can be put. *See* Joint Appendix at 468-95; *id.* at 565-78. Even assuming that it would have been reasonable to rely exclusively on the descriptions contained in these brochures, there is no basis to rely on them for the proposition that it was safe to transport natural gas in 3T cylinders. Rather, the brochures, under the heading of "description," state that "USS Seam-

less Pressure Vessels offer great inherent strength and reliability in handling hydrogen, nitrogen, air, helium, oxygen, and other gases." *Id.* at 472 and 567. The same list is repeated under "typical applications." *Id.* at 477 and 569. Thus, even if the brochures are seen as intended to have induced reliance, they could not reasonably have been relied on to transport natural gas without further inquiry.

As further evidence of reliance, Mattingly asserts in his brief that after the explosion, USS and Kelley continued to assure him that 3T tubes were safe for transporting natural gas and that he should resume his business. *Id.* at 914-15. Under Kentucky law, CGC must show that its reliance on the misrepresentation was the cause of the injury. The damages claimed by CGC cannot be attributable to USS's alleged *post*-explosion misrepresentation. Since CGC never resumed business, CGC could not have relied on USS's alleged assurances. In short, we are unimpressed by the evidence of fraudulent misrepresentation. Plaintiff cannot surmount the first two important hurdles in the test to establish fraud: i.e., that there was a misrepresentation, and that there was reliance. We need proceed no further in our inquiry on the fraud issue.

We therefore reverse with respect to the claim that USS and Kelley fraudulently misrepresented the use of the 3T steel tubes, and remand the case back to the district court with instructions to proceed solely on a negligence theory of liability. We recognize that this decision necessarily affects USS's and Kelley's claim on appeal that the jury instructions given at trial improperly mingled the damages theories as to fraud and negligence. Since on remand the case will be tried only on a negligence theory, there will be no need for an instruction as to the legal theory of fraudulent misrepresentation. A single damages instruction would therefore be acceptable under this singular theory of liability.

B. *Lost Profits Instruction*

The jury awarded CGC $1,137,154 in lost profits as a result of the cylinder explosion. Defendants USS and Kelley challenge the jury instruction on lost profits, claiming that such damages in this case fail for lack of the required certainty under Kentucky law. We agree.

Kentucky law requires that CGC establish the fact of lost profits with reasonable certainty. *Paulines Chicken Villa, Inc.* v. *KFC Corporation,* 701 S.W. 2d 399, 401 (Ky. 1985).[2] *See also Mitchell Coal Company* v. *United Mine Workers of America,* 313 F. 2d 78 (6th Cir. 1963), where this court held that the *Mitchell* plaintiff had not produced enough evidence of lost profits to take its claim to the jury. This court wrote:

> The [plaintiff] had been in business only a few months and had operated at a loss before the happening of the events complained of here. There was no showing that it could have operated at a profit. Even under the liberal rule in *Story Parchment Co.* v. *Paterson Parchment Paper Co.,* 282 U.S. 555, 51 S.Ct. 248, 75 L.Ed. 544 the loss of profits must be established by at least a

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[2]The *Paulines* court set out in that case the facts that had removed "virtually all the uncertain variables":

> [1] This is a national franchisor, [2] with uniformity of national advertising, [3] uniform quality control, [4] earnings and expense figures on nearby and comparable locations, [5] and an available history concerning success and failure ratios. The franchisee, likewise, [6] is experienced in the field and with the specific product, with [7] a proven record of operation and management, [8] a history of profit and loss, [9] with two current operations in the general area, etc.

701 S.W. 2d at 401-402.

Not one of these nine factors exists in this case.

> reasonable probability and not on sheer speculation and guesswork.

Mitchell, 313 F. 2d at 79.

As defendants point out in their brief, CGC's claim for lost profits is speculative at best. The company was newly formed, in a relatively new industry, and dependant upon the unpredictable gas market at a time when there was an oil crisis. CGC operated only for a total of ten days and transported only eleven loads or partial loads of gas. It never made a profit. CGC had only one customer. Don Fowler, the president of Texas Gas, a gas transport operation 900 miles from CGC, testified that Texas Gas made little or no profit in its gas transport operation, Joint Appendix at 1066, 1978-80, and had never operated in Kentucky because it could not find gas wells of a quality and quantity sufficient to warrant the cost of establishing an operation. *Id.* at 1076. Thus, it would appear that CGC had little hope of making any profit, or of continuing in business at all.

CGC's proof of lost profits consisted of the testimony of Dr. Donald Monath, whose calculations were derived merely from subtracting CGC's estimated expense figures from the revenues CGC would realize if it operated at maximum capacity, 365 days a year for ten years. Monath concluded that CGC would have made $1,137,154 over ten years. *Id.* at 964. He made no effort to determine whether CGC in fact could make a profit or could continue to operate in the area. He was not informed as to how CGC developed its cost estimates, how long the company had operated, the nature of the product, or the level of CGC management's experience. *Id.* at 945, 968-71, 975. It is apparent to us that these figures were far too speculative to permit an instruction on lost profits. We therefore reverse with respect to this issue as well, holding that the evidence on lost profits was insufficient to warrant submitting that issue to the jury.

C. *Other Issues*

We assume, without deciding, that defendants did not waive the issue of the 12% post-judgment interest rate applied to their verdict by the district court. We believe that the district court incorrectly applied an interest rate in excess of the statutory mandate, and that on remand, the district court should be guided by 28 U.S.C. § 1961 in applying an interest rate to any verdict that may result from the new trial.

We have carefully reviewed the other claims on appeal and on cross-appeal, and are unable to conclude that they also constitute reversible error. We therefore affirm on the remaining issues.

III. CONCLUSION

For the reasons set forth above, we REVERSE on the issues of fraudulent misrepresentation and lost profits, and REMAND the case back to the district court for a new trial, to proceed on a negligence theory of liability only. We instruct the district court to apply the proper interest rate to the damages verdict, if any, on remand. The jury verdict below is VACATED. We AFFIRM on all remaining issues.

APPENDIX 3

No. 87-5535/5608

UNITED STATES COURT OF APPEALS

FOR THE SIXTH CIRCUIT

COMPRESSED GAS CORPORATION, INC., - - - - - - - *Plaintiff-Appellee, Cross Appellant,*

v.

UNITED STATES STEEL CORPORATION and JACK B. KELLEY, INC., - - - *Defendants-Appellants, Cross Appellees.*

BEFORE: KEITH, KENNEDY and NELSON, Circuit Judges.

ORDER—Filed November 9, 1988

The Court having received a petition for rehearing en banc, and the petition having been circulated not only to the original panel members but also to all other active judges of this Court, and no judge of this Court having requested a vote on the suggestion for rehearing en banc, the petition for rehearing has been referred to the original hearing panel.

The panel has further reviewed the petition for rehearing and concludes that the issues raised in the petition were fully considered upon the original submission and decision of the case. Accordingly, the petition is denied.

Entered by Order of the Court

(s) Leonard Green
Leonard Green, Clerk